



Institute for
Fiscal Studies

Housing taxation and housing benefits

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This presentation

- Based on S. Adam (2013), *Housing taxation and support for housing costs* (www.ifs.org.uk/publications/6773)
- Which in turn draws heavily from Chapter 16 of *Tax by Design: the Mirrlees Review* (www.ifs.org.uk/mirrleesreview)
- Key idea: housing is both a consumption good and an asset
 - Tax system should treat it appropriately from both perspectives
 - Starting point is neutrality: treat similar activities similarly

Outline

- Taxation of housing as a consumption good
- Taxation of housing as an asset
- ‘Dry’ taxes and the possibility of deferral
- Support for housing costs in the benefits system

Not covered:

- Non-residential property and business rates
- The local dimension
- Macroeconomic aspects (dealing with bubbles)
- Interaction with planning regime and other aspects of housing policy

Property taxation vs. land taxation

- Property = land + buildings
 - Could tax these two parts differently
 - But if OK to tax them equally, simplest to tax combined value
- Taxing land value is efficient
 - Fixed supply, and value determined by location, not actions of owner
 - No way for taxpayer to reduce liability, so no disincentive effects
 - Windfall loss to landowner on day tax announced
 - NB efficient \neq equitable: fair to impose losses on landowners?
- Should we tax buildings too?
- Not business buildings: an intermediate input into production
 - So replace business rates with a land value tax (if valuation feasible)
- But I will argue there is a case for taxing residential buildings
 - So levy appropriate tax on whole property value

Taxing goods and services

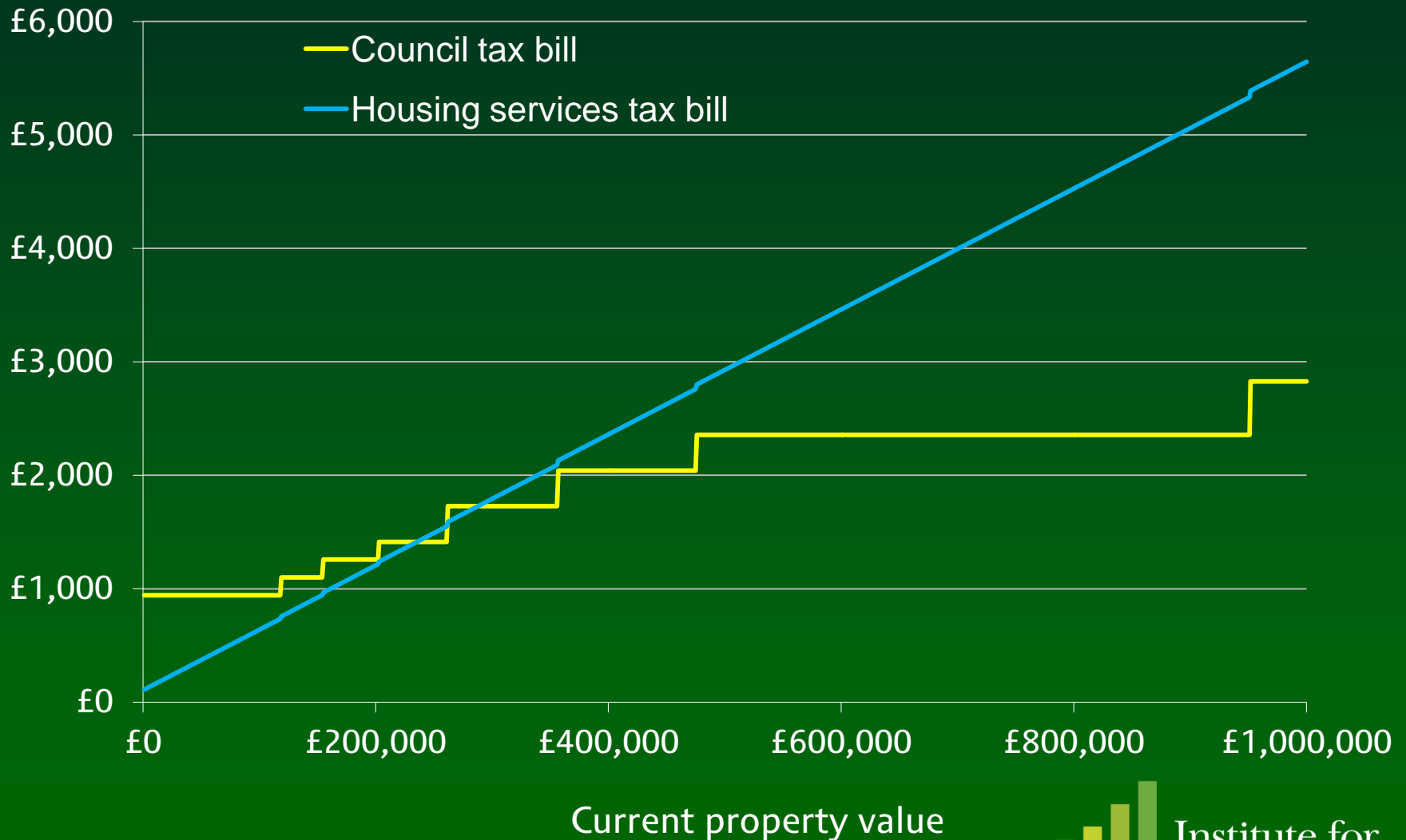
- Only final consumption should be taxed
 - Not transactions (stamp duties) or produced inputs (business rates)
- Presumption to tax all consumption equally
 - Not least for reasons of simplicity
- There are exceptions to this
 - Where consumption is damaging (sin taxes, green taxes)
 - Where consumption is associated with work (childcare)
- But tax breaks for necessities on distributional grounds is NOT an exception
 - More efficient to redistribute based on total income/expenditure, without distorting people's choices between goods
 - So should broaden the VAT base, with a compensation package

Taxing consumption of housing services

- Housing should be taxed like other consumption
- Two ways this could be done:
 1. VAT on new build
 2. Annual tax on the stream of consumption
- From where the UK is starting, the latter makes more sense
- Tax the annual consumption value of housing: substitute for VAT
- Looks like a sensibly reformed council tax
 - Based on up-to-date valuations (rather than 1991 valuations)
 - Proportional to value (rather than regressive with wide bands)

A 'housing services tax'

Note: rough guide for 2009-10 only – see Mirrlees Review for details



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- Looks like a sensibly reformed council tax
 - Based on up-to-date valuations (rather than 1991 valuations)
 - Proportional to value (rather than regressive with wide bands)
 - No discounts for single occupancy (rather than 25% discount)
- Ideally based on rental values rather than capital values
 - But there may be a trade-off with practicality here

Taxing property as an asset

- Property is an investment as well as a consumption good
 - Returns are (actual or imputed) rent and capital gains
 - Should be part of coherent regime for taxation of savings and wealth
- Key to effective savings taxation is neutrality across:
 - Consumption today vs tomorrow (don't discourage saving)
 - Different assets (rental vs owner-occupied; property vs other assets)
 - Different income sources (labour earnings vs return to savings)
 - Different forms of return (income vs capital gains)
 - Different legal vehicles (direct investment vs incorporation)
 - Varying inflation rates
- Current system achieves none of these: can we do better?

Assets: what might we tax?

Investment returns (income tax and capital gains tax)

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Stocks of wealth (wealth tax)

- If we had a wealth tax, no reason to exclude housing
- Equally, no principled reason to tax housing but not other wealth
- Annual wealth tax doubtful on both economic and practical grounds

Assets: what might we tax?

Investment returns (income tax and capital gains tax)

Stocks of wealth (wealth tax)

Gifts and bequests (inheritance tax)

- Existing tax in need of radical reform
- But again, no reason to treat housing differently from other assets
- New residence nil rate band favours owner-occupied housing

Assets: what might we tax?

Investment returns (income tax and capital gains tax)

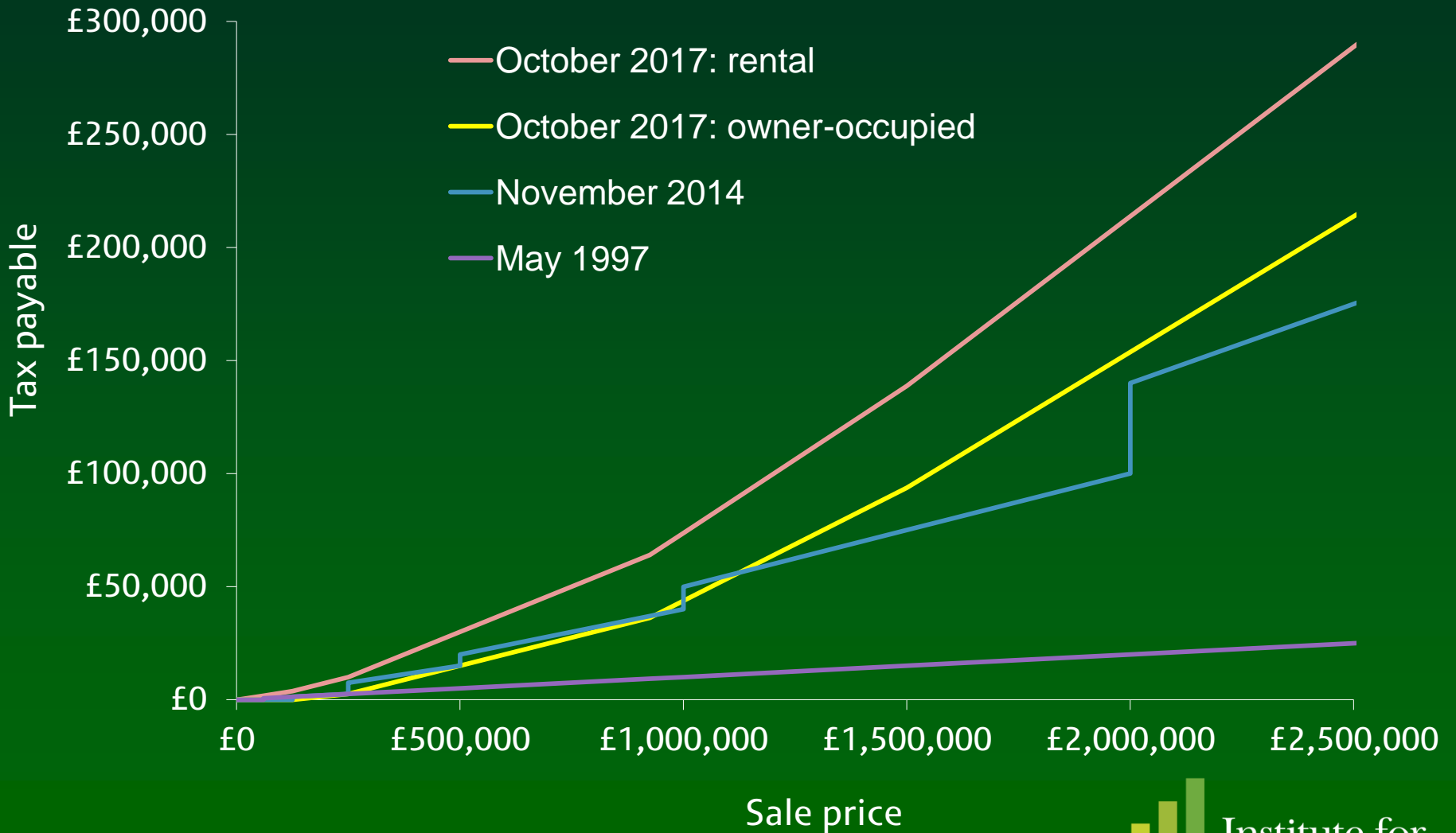
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Transactions (stamp duty land tax)

- Basic principle that transactions should not be taxed
 - Why impose heavier tax on properties that change hands more often?
 - Assets should be held by the people who value them most
 - Reduced labour mobility one symptom of this more fundamental problem
- Stamp duties should not be part of the tax system

Stamp duty land tax on housing transactions



Assets: what might we tax?

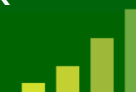
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- Stamp duties should not be part of the tax system
 - But don't want to give up revenue / give windfall gains to current owners
- So look to replace with better taxes rather than simply abolish
 - Make up revenue through higher 'housing services tax'



Four options for savings taxation

1. Standard income tax (TTE)
 - Tax earnings and (nominal) capital income and gains
 - Like interest-bearing accounts, shares and **rental housing**
2. Earnings tax (TEE)
 - Tax earnings, but exempt (ignore) capital income and gains
 - Like ISAs and **owner-occupied housing** (and NICs in general)
3. Cash-flow expenditure tax (EET)
 - Tax relief for amounts saved; ignore returns within fund; tax withdrawals
 - Like pensions
4. Rate-of-return allowance (TtE)
 - Tax earnings, but only tax capital income and gains above a 'normal' rate
 - Like Norwegian shareholder income tax

Taxation of rental vs owner-occupied housing

Rental

Owner-occupied

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Income tax on rental income

CGT on capital gains

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Income tax on rental income

No tax on imputed rental income

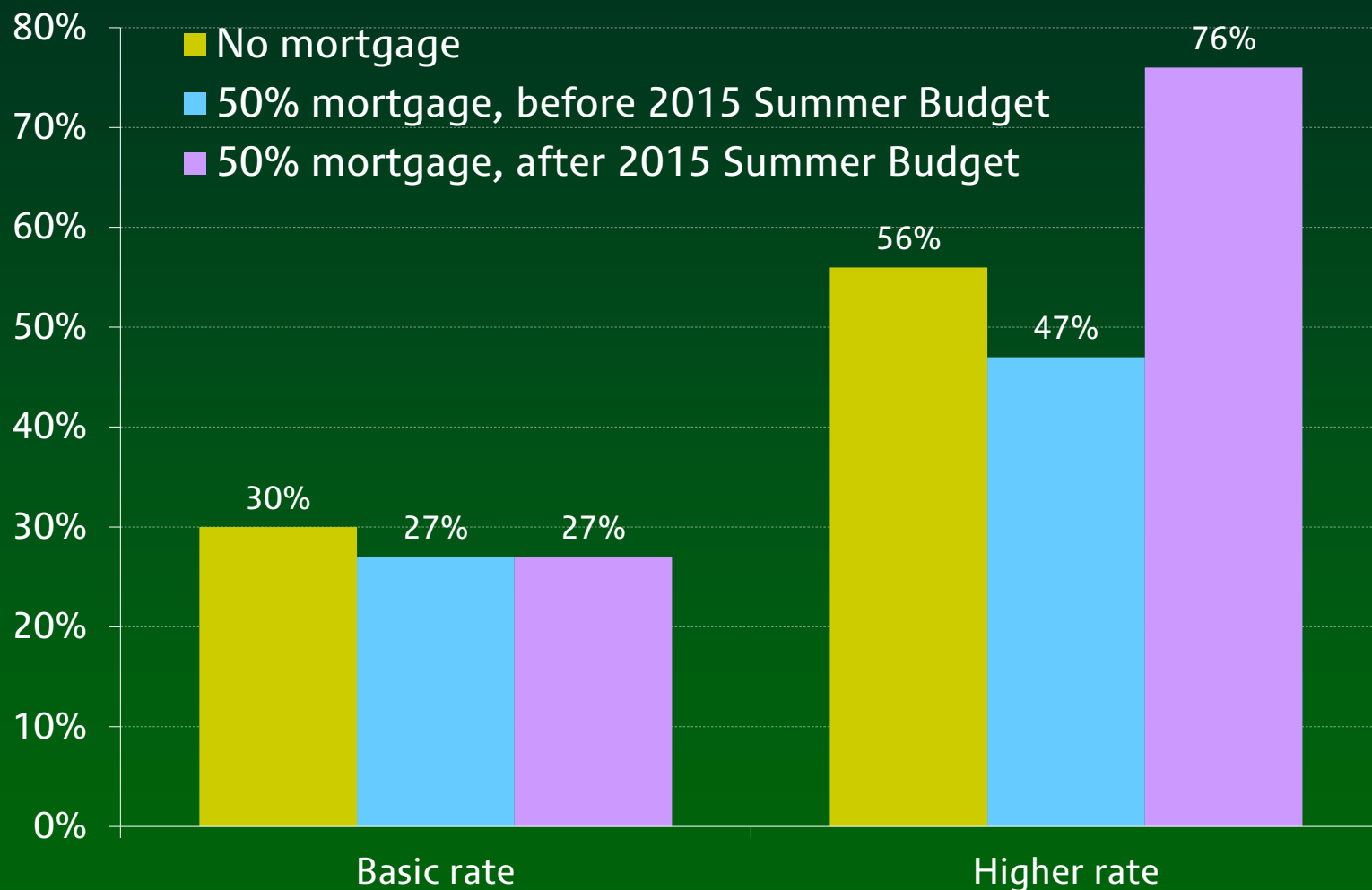
CGT on capital gains

No CGT

Taxation of rental vs owner-occupied housing

Rental	Owner-occupied
Income tax on rental income <ul style="list-style-type: none">– and mortgage interest deduction restricted to basic rate	No tax on imputed rental income
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ETR on 10-year buy-to-let investment



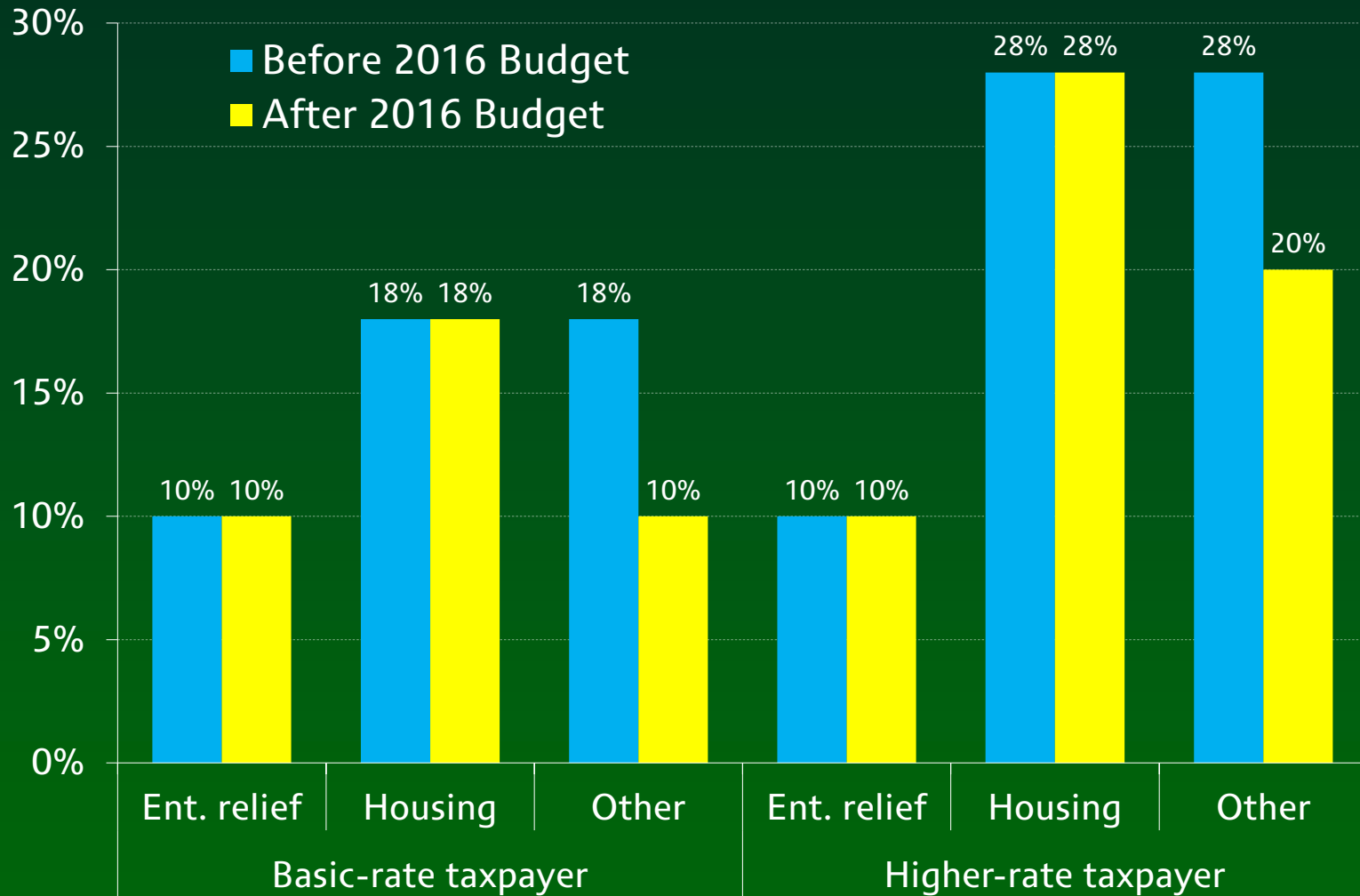
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Capital gains tax rates



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- Rental housing now the most heavily taxed major asset class, whereas owner-occupied housing subsidised

Taxation of rental vs owner-occupied housing

- Subsidising owner-occupation largely ineffective in making housing more affordable overall
 - Supply constrained by planning restrictions etc, so just bids up prices
- But does affect the allocation of housing
- Debatable whether any justification for favouring owner-occupation
 - But certainly not on this scale
 - And certainly not in this odd cocktail of ways

Reforming the taxation of property income

- Current regime for rental property distorts behaviour
 - Investing in property is discouraged
 - Inflation and capital gains cause particular problems
- Current regime for owner-occupiers seems too generous
 - Enormous returns (including disguised labour) go untaxed
- And distinction creates major bias in favour of owner-occupation
 - And between each of them and many other assets
- A rate-of-return allowance alleviates all these problems

A rate-of-return allowance for rental property

- Based on current system
 - Taxing both rental income and capital gains
- But with an allowance for a ‘normal’ return on the investment
 - EITHER deduct (say) 3% of purchase price from rental income each year; tax capital gains at full marginal income tax rate
 - OR tax rental income in full, but charge CGT only on gains relative to a purchase price stepped up by (say) 3% per year
- ‘Excess’ returns should be taxed at full labour income tax rates
 - Including full (employee + employer) NICs
 - Applies to capital gains as well as income
- Abolish tax relief for mortgage interest
 - (Or give relief for interest in excess of a ‘normal’ rate)



A rate-of-return allowance for owner-occupiers?

- Similar, but using imputed rent instead of actual rent
 - Imputed rent is exactly what is assessed for the Housing Services Tax
- Same two implementation options now take on a different slant
 - EITHER deduct (say) 3% of purchase price from imputed rental income each year; tax capital gains at full marginal income tax rate
 - *Would people just wait for the next government to repeal CGT?*
 - OR tax imputed rental income in full, but charge CGT only on gains relative to a purchase price stepped up by (say) 3% per year
 - *Is charging VAT + income tax + NICs rates on imputed rent each year politically realistic?*
- Retain current treatment of owner-occupied housing for now?
 - RRA for rental property alone would still be a major improvement

Difficulty paying housing taxes

- Housing has important advantages as a tax base
 - Immobile, supply (and demand) unresponsive to price, ownership easily established
- But owner-occupied housing has one big disadvantage
 - The stream of services is not linked to a cash flow
- Distinguish between two different concerns:
 1. Well-off people who own a valuable asset but lack liquidity
 - *Allow deferral of tax payments as a form of loan?*
 2. People who lack the underlying ability to pay
 - *The state benefits safety-net should incorporate an allowance for housing costs (including housing taxes)*

Deferral of housing tax payments

- Would help some taxpayers; but should government be wary?
- Deferral should always be with interest
 - Interest-free loans give preferential treatment to those who pay later – unfair, inefficient and potentially expensive
- Allow deferral only until sale of property or death
- Secured against housing equity
 - So restricted to home-owners
 - And perhaps restricted to those who lack the liquidity to pay the tax?
 - Those with no current income or net assets get outright support instead
- Long-term credibility of the policy matters
 - Government & taxpayers need to be sure the tax will ultimately be paid
 - Political consensus therefore especially valuable
 - Err on the restrictive side until well established?

Support for housing costs

- Housing taxes are one part of housing costs
- Benefit system provides a ‘safety net’ to guarantee minimum income
 - Housing is clearly an essential of life which should be included
 - No judgement on how generous it should be
- Best to include housing support in an integrated benefit
 - Assess total needs and total resources
 - Universal credit is a (partial and imperfect) attempt to do this
- If means-testing on assets as well as income, don’t exclude housing
 - Housing is illiquid, but that’s what loan/deferral is for
- 2018 change to Support for Mortgage Interest follows this logic
 - Since own valuable property, the issue is cash-flow, not poverty
 - So give loan, not benefit; time-limited, secured against property,...

Support for actual or 'reasonable' housing costs?

- If level of housing costs is a choice, 'reasonable' is better
 - Taxpayer shouldn't pay for me to choose somewhere expensive
- If level of housing costs is fixed, 'actual' is better
 - These costs are part of my basic needs: real hardship if not covered
- Reality is somewhere in between
 - Short-run vs long-run
 - Social vs private housing
 - Rent + tax vs energy + water bills
 - Area vs specific property
- No simple 'right answer'

Support for actual or 'reasonable' housing costs?

- Historically, UK benefits based largely on actual housing costs
 - HB covered actual rent; CTB covered actual council tax
 - SMI mixed: actual mortgage (up to cap) but assumed interest rate
- But actual rent decreasingly relevant for housing benefit
 - Local housing allowance originally envisaged as pure 'reasonable cost' basis, though retreated to using actual costs up to 'reasonable' cap
 - Cap reduced (from 50th to 30th percentile of 2012 local rents)
 - Cap uprated with CPI instead of tracking local rent changes
 - Nationwide cap on weekly benefit as well
 - Under-occupancy charge ('bedroom tax') cuts HB if property 'too big'
 - ❖ NB could instead have reduced cost by cutting % of actual rent covered
- Council tax support localised: end of a national after-tax safety net
 - Now up to individual councils to decide what to cover



Conclusion: recommendations for reform

- Replace council tax and SDLT on housing with a ‘housing services tax’ to stand in place of VAT
 - Proportional to up-to-date values
- Introduce a ‘rate-of-return allowance’ regime for rental property
 - And perhaps owner-occupied housing in the (even) longer term
- Reverse recent ad hoc policies that exacerbate bias:
 - Subsidies for owner-occupation: IHT, LISAs
 - Penalties for buy-to-let: mortgage interest restriction, SDLT supplement
- There is a case for allowing some home-owners to defer payment
 - With interest, until sale of the property or death
- Benefits should include an allowance for (actual or ‘reasonable’) housing costs
 - Preferably as part of a single integrated benefit